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CHANGES IN FOOD WHOLESALING

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CHANGES IN FOOD WHOLESALING

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ABSTRACT: Food wholesaling establishments have increased their sales by about one-half in the past decade. Food wholesaling has had a dynamic change in shares (percent of sales of a market by type of firm) while margins and profits as a percent of sales have remained constant. Affiliated wholesalers have increased their share of the food store market, with other wholesalers shifting sales to industrial and commercial users.

KEY WORDS: Food wholesalers, margins, marketing costs.

Wholesaling is the market function of purchasing, assembling, and distributing goods for resale to retail outlets. The wholesaling function may be performed by an independent firm or a unit of an integrated retailer. The establishments performing the wholesaling function and the markets served by such wholesalers changed dramatically during the 1960's.

Food wholesaling has traditionally been considered a function of independent firms. Developments have eroded this view as varying degrees of integration have transferred a substantial part of the wholesaling function to other types of organizations in the market channel for food.

An example of transfer in the control of the wholesaling function is the integrated retailer who performs his own buying, assembling, and distribution. By taking over the wholesaling function, integrated retailers (when large enough) have been able to realize savings through volume purchasing and the control and co-ordination of the other wholesaling functions. Integrated retailers' share of total food store sales increased only slightly from 1963 to 1969. Still, they account for almost half of total retail food store sales. This dominance places constant competitive pressure on non-integrated retailers.

The response to the competitive pressure can be seen in actions both by retailers and wholesalers in the 1960's. Many non-integrated retailers built larger stores and looked at alternatives for reducing the cost of acquiring their merchandise from many wholesalers. Many of these non-integrated retailers organized cooperatives or joined voluntary groups to realize savings from volume purchasing.

Wholesalers responded by adopting changes which provide non-integrated food retailers with products and services at a cost that would permit them to be competitive with the integrated retailer. Many wholesalers organized voluntary groups of retailers that contract for merchandise and services from the wholesaler. Other wholesalers not forming voluntary groups increased their sales to the away-from-home market including restaurants and hotels.

The dominant alternative wholesaling structure that has emerged for the retail food store in response to this competition is the affiliated wholesaler. Affiliated wholesalers are of two types: Cooperative wholesale buying groups and voluntary merchandising groups. Cooperative wholesalers are those owned by the retailers they serve. Voluntary wholesalers are firms contracting to serve independent stores and chains often operating under a common name.

In 1963 affiliated stores accounted for about one-third of grocery store sales while integrated chains accounted for two-fifths (fig. 6). However, in 1969 affiliated stores accounted for about the same proportion of grocery store sales as integrated chains (46-47 percent). Sales of independent stores—those not affiliated with a cooperative or voluntary group—declined from about one-fourth in 1963 to less than one-tenth in 1969.

To analyze the changes in the food wholesaling structure during the last decade, we examined 4 key indicators of performance: market share, gross margin, profit, and capital efficiency. The market share analysis was centered around sales to retail food stores and the secondary market for food away from home. This

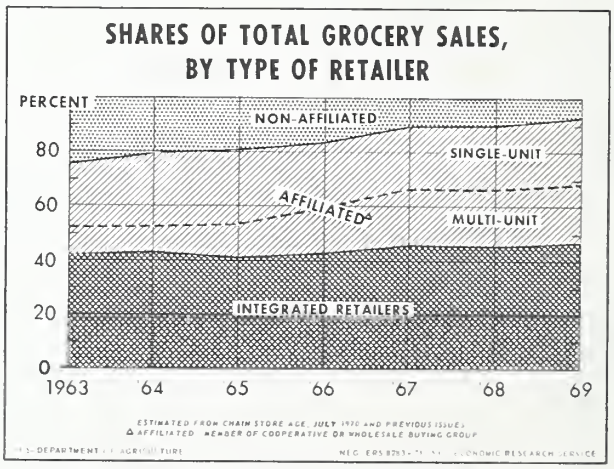

Figure 6

enabled us to study the effect of affiliated wholesalers, integrated retailers, non-affiliated general-line grocers, and specialty wholesalers on the wholesale marketing enviroment. Margin data were obtained from the *Census of Business* for all firms. However, the Internal Revenue Service data on profits and capital efficiency by size category relate only to corporate firms.

Market Share

In 1967, 88 percent of sales by general-line grocery wholesalers was to food stores (table 6). The remainder was distributed among public eating places, institutions, and others. This analysis will concentrate on the change in market shares of wholesalers selling to retail grocers.

Affiliated Wholesalers

Affiliated grocery wholesalers—those sponsoring voluntary groups of retail food stores and those cooperatively owned by retail food stores—are now accounting for sales about equal to those of food stores performing their own wholesaling function. Moreover, the sales growth of affiliated wholesalers and their retailers is increasing at a faster pace than growth in integrated food stores.

The rapid rate of growth by affiliated wholesalers may not continue long into the seventies. Up to this point affiliates' growth in market share has been at the expense of the non-affiliated independent wholesaler and his independent food store customer. The continued growth in market share of affiliated retailers will depend to a larger extent on cost and quality of services and merchandise provided by the affiliated wholesaler and ability of the retailer to use these services effectively.

Affiliated wholesalers have grown both in total sales and number of establishments. Affiliated wholesalers had sales per establishment five times those for non-affiliated wholesalers in 1967 (table 7). The number

Table 6.--Food wholesalers: Distribution of sales to industrial and commercial users and retail food stores, 1958, 1963 and 1967

Type of business	Industrial and commercial users 1/			Retail food stores		
	1958	1963	1967	1958	1963	1967
	Percent 2/					
Merchant wholesalers	13	18	23	64	62	58
Groceries, general line	5	6	10	94	91	88
Affiliated	3	3	3	96	96	95
Voluntary	--	4	5	--	95	94
Cooperative	--	1	1	--	98	98
Non-affiliated	7	15	28	90	78	68
Specialty wholesalers	18	25	36	49	45	40
Frozen foods	--	--	43	--	--	31
Dairy products	21	25	18	39	35	38
Poultry & poultry products	8	17	19	54	54	53
Confectionery	3	9	21	80	72	60
Fish & seafood	9	19	35	46	38	25
Meat & meat products	21	32	34	50	42	40
Fresh fruits & vegetables	11	16	19	58	54	48
Agents and brokers	--	15	16	--	29	28
Assemblers	9	14	16	35	31	31

1/ Refers to customers who normally buy for business uses rather than for resale. (Primarily the away-from-home market)
2/ Does not add to 100%. Omitted portion refers to food sold to other wholesalers or government.

Compiled from: Census of Business, Department of Commerce.

Table 7.--Merchant wholesalers: Total sales, number of establishments, and sales per establishment, 1958, 1963, and 1967

Type of business	Total sales		
	1958	1963	1967
	Million dollars		
Groceries, general line	8,428	11,723	15,548
Affiliated	5,236	8,270	11,470
Voluntary	---	5,357	7,367
Cooperative	---	2,913	4,103
Non-affiliated	3,192	3,453	4,078
Specialty wholesalers	16,772	19,131	26,004
Frozen foods	---	---	1,771
Dairy products	1,934	2,185	2,678
Poultry & poultry products	1,462	1,629	2,180
Confectionery	747	858	1,030
Fish and seafood	622	693	856
Meat & meat products	3,879	5,371	7,395
Fresh fruits & vegetables	3,092	2,981	3,973
Groceries and related products, nec	5,036	5,415	6,121
Total	25,200	30,854	41,552
	Establishments		
	Number		
Groceries, general line	2,253	2,530	2,543
Affiliated	673	869	907
Voluntary	---	708	734
Cooperative	---	161	173
Non-affiliated	1,580	1,661	1,636
Specialty wholesalers	27,769	26,760	26,508
Frozen foods	---	---	1,365
Dairy products	3,067	3,000	2,785
Poultry & poultry products	2,082	1,942	2,022
Confectionery	2,113	2,084	1,998
Fish and seafood	1,591	1,602	1,534
Meat & meat products	4,459	5,170	5,041
Fresh fruits & vegetables	6,291	5,123	5,284
Groceries and related products, nec	8,166	7,839	6,479
Total	30,022	29,290	29,051
	Sales per establishments		
	Thousand dollars		
Groceries, general line	3,741	4,634	6,114
Affiliated	7,780	9,517	12,646
Voluntary	---	7,566	10,037
Cooperative	---	18,094	23,717
Non-affiliated	2,020	2,079	2,492
Specialty wholesalers	604	715	937
Frozen foods	---	---	1,297
Dairy products	631	728	961
Poultry & poultry products	702	839	1,078
Confectionery	354	412	515
Fish and seafood	391	432	558
Meat & meat products	870	1,039	1,467
Fresh fruits & vegetables	492	582	752
Groceries and related products, nec	617	691	945

Compiled from: Census of Business, Department of Commerce.

of affiliated wholesale establishments increased by more than a third from 1958 to 1967 to a total of 907 firms. The growth of affiliated wholesalers has been due to the active recruiting of retailers by offering them services and competitive advantages similar to those available to the integrated retailer.

Sponsoring of retailers affords the wholesaler a relatively stable base of customers who contract for his services. The affiliated wholesaler often provides the retailer with a full line of merchandise, promotional programs, service specialists in store operations, and managerial assistance. Many large affiliated wholesalers have their own electronic data processing (EDP) facilities. This allows automatic reorder and other managerial analysis. Computerized check-out and other data analysis techniques on product movement at retail will require access to computers for which the wholesaler is the logical source of support. Individual stores, using EDP provided by their wholesaler, can adapt the merchandise mix to the needs and preferences of their neighborhood.

Unit pricing is one recent development that needs the speed of a computer. This practice is a labor consuming activity which can be minimized by access to computer printed labels. Legislation requiring unit pricing is now in effect in New York City and Massachusetts. In other areas legislation is being considered and many firms are voluntarily using unit pricing as a competitive tactic. Without computer access, unit pricing and variable price merchandising may be prohibitive. The development of unit pricing as a retail merchandising practice should favor the growth of the affiliated wholesaler at the expense of the independent wholesaler.

Many voluntary groups provide financial assistance, accounting, store design, site location, advertising, store employee training, private labels, and many other services designed to improve retail effectiveness. Services provided by retailer-owner cooperatives vary, though many are expanding them. This type of operation provides the retailer dual benefits: The economies resulting from purchasing in large quantities and a share of any profits earned by the cooperative.

Multi-unit retailers (2 or more store) of affiliated groups tripled sales from 1963 to 1969. The absolute dollar sales growth of multi-unit retailers equaled the growth of integrated retailers. The rapid sales growth of multi-unit retailers resulted from their adoption of a marketing strategy similar to that of integrated retailers. Many of these multi-unit retailers were small and lacked the volume to support the use of their own warehouses. As a consequence, many multi-unit retailers have closed their own warehouses or, when expanding into new areas, have chosen to use affiliated wholesalers. Existing cooperatives and voluntary groups have been active in responding to the needs of multi-unit retailers.

Single stores belonging to cooperative and voluntary groups showed a modest increase in sales of $4 billion from 1963 to 1969. Part of this increase was due to the switching of single stores from independent wholesalers to voluntary or cooperative suppliers. On the other hand, many single stores belonging to voluntaries or cooperatives grew to multi-unit operations during this period.

Non-Affiliated Wholesale Establishments

Sales and number of non-affiliated general-line wholesale establishments rose between 1958 and 1967 in contrast to the slight decline in total wholesale grocery establishments. However, the share of non-affiliated establishments' sales to food stores declined. This decline was more than offset by sales to industrial users. Between 1958 and 1967, their percentage of sales to industrial users, including public eating places, increased four times.

Specialty Wholesalers

Specialty wholesalers, like the non-affiliated general-line grocery wholesalers, have increased sales to the expanding away-from-home market in the past decade. Since integrated and affiliated warehouses have tripled the number of items handled, specialty wholesalers have found it harder to compete in the food store market.[1] In rural areas where large institutions and eating places were not present, general-line and specialty wholesalers lost much of their market to the affiliated wholesaler.

Gross Margins

Gross margins and operating expenses as a percent of sales vary by type of wholesaler (table 8). General-line grocery wholesalers have the lowest gross margin. Fresh fruit and vegetable specialty wholesalers have the highest gross margins as a percent of sales as a result of their relatively higher operating expenses for refrigeration and the loss of products due to spoilage. Other specialty wholesalers have a higher gross margin than general-line grocery. Wholesalers who handle goods requiring special conditions such as cold storage for meat and frozen foods have higher margins to cover costs.

Traditional general-line grocery wholesalers (non-affiliated) have higher operating expenses than affiliated wholesalers (voluntary and cooperative). The affiliated wholesalers have achieved some competitive advantages through economies of scale, primarily because they serve larger volume retailers. They have also offered more services to their retailers.

The cooperative wholesalers have lower operating costs than the voluntary wholesalers. The cooperative wholesalers tend to serve only retail food stores, while the voluntary wholesalers have begun to serve the away-from-home food market. Because of larger deliveries to the food stores than restaurants, it is cheaper to service the retail food store. Cooperative wholesalers have about two and one-half times the sales per establishment as the voluntary wholesalers.

[1] *Progressive Grocer*, April, 1970, page 75.

Table 8.--Merchant wholesalers: Gross margins and operating costs as a percent of sales, 1958, 1963 and 1967

Type of business	Gross margin		Operating expenses including payroll		
	1963	1967	1958	1963	1967
	Percent				
Groceries and related products	11.7	12.0	9.4	9.5	9.5
Groceries, general line	8.0	9.1	6.4	6.7	6.4
Affiliated	--	--	5.3	5.5	5.5
Voluntary	--	--	--	6.2	6.1
Cooperative	--	--	--	4.5	4.4
Non-affiliated	--	--	8.2	9.2	9.0
Specialty line	14.9	14.4	11.0	11.6	11.1
Meat and meat products	10.9	11.7	8.7	9.9	9.8
Fresh fruits & vegetables	17.5	15.6	14.8	13.7	14.5

Compiled from: Census of Business, Department of Commerce.

Labor was the food wholesalers' largest operating cost, accounting for slightly less than half of the gross margin in 1967.[2] Business taxes were the second major cost.[3] Depreciation and rent, because of large capital requirements, followed in order of importance.

Profits of Corporate Wholesalers

Despite a changing market volume of business during the 1960's, profit ratios as a percent of sales showed little change. Food wholesalers' profits between 1958 and 1967 (latest data available) averaged slightly less than 1 percent of sales and more than 11 percent of net worth.[4] Profit ratios varied by asset size (table 9).

The largest firms had the highest profit rates, averaging about 1 percent of sales and close to 12 percent of net worth. The medium size wholesaler did about as well as the larger size. However, the smallest wholesalers' profit ratios averaged less than one-half of 1 percent of sales and only 3 percent of net worth.

Small wholesalers had returns on net worth averaging less than half of the prime interest rate (6-8%). Economic theory for competitive markets would indicate that with a passage of time there should be an exodus of such firms with capital flowing to more productive uses. Such a mass liquidation has not occurred. On the contrary, small wholesalers account for one-half of all corporate wholesalers. The number of small corporate wholesalers has remained constant in recent years even though they account for only 7 percent of the corporate sales.

Capital Efficiency of Corporate Wholesalers

Capital productivity is related to size of firm for food wholesalers. Larger firms substitute capital for labor and are less efficient users of capital (when considered by itself) then their smaller rivals. This does not imply that the smaller firm is optimal in the use of all inputs.

Sales per dollar of assets provide a measure of efficiency with respect to total capital necessary to conduct a business. This measure suffers when using traditional accounting sources because of the mixed practice of leasing capital goods or owning them. Owned capital appears on the balance sheet as an asset; leased facilities do not. Small wholesalers had the highest sales per dollar of assets, averaging more than 7 to 1 for the period (table 10). The largest wholesalers averaged 5 to 1, which was the same as the average of all firms. This reflects the weight of larger size wholesalers.

Sales per dollar of inventory provide a direct measure of capital efficiency with respect to the product being distributed. This is a more meaningful measure of capital efficiency in the trade industries than in manufacturing. All wholesalers averaged $19 of sales to $1 of inventory during 1963-69. Small wholesalers were more efficient in inventory turnover, averaging 46 to 1.

[2] *Census of Business, 1967*, U.S. Department of Commerce.
[3] *Statistics of Income, 1967*, Internal Revenue Service. [4] IRS data for profits as a percent of net worth fluctuated widely from year to year as a result of changes in classification.

Table 9.--Corporate food wholesalers' profits before taxes as a percent of sales and net worth, by asset size of firm, 1958-67

Years	Asset size of firm			
	All firms	Under $100,000	$100,000 to $1 million	Over $1 million
	Profits as percentage of sales			
1958	0.9	0.1	0.8	1.1
1959	0.9	0.3	0.8	1.1
1960	0.9	*	0.9	1.1
1961	1.0	0.1	0.9	1.2
1962	1.0	0.4	0.8	1.1
1963	0.7	0.1	1.0	0.7
1964	0.9	0.4	0.9	1.0
1965	1.0	0.3	1.2	0.9
1966	1.0	0.4	1.1	1.0
1967	1.0	*	1.1	1.0
Average	0.9	0.2	1.0	1.0
	Profits as percentage of net worth			
1958	10.0	1.9	7.6	10.1
1959	9.4	3.5	8.5	10.6
1960	8.6	-3.1	8.4	9.9
1961	11.1	1.0	10.8	12.2
1962	NA	NA	NA	NA
1963	9.5	2.7	12.2	8.2
1964	12.2	10.5	11.4	12.9
1965	13.3	5.1	15.1	12.8
1966	13.8	7.3	15.2	13.4
1967	12.0	-1.2	10.8	13.3
Average	11.1	3.1	11.1	11.5

* Less than 0.1 percent

Compiled from: Source Book of the Statistics of Income, Internal Revenue Service, 1958 through 1967 (latest available data).

The capital efficiency of small wholesalers is a result of handling a limited line of products and of not having enough sales volume to efficiently use larger laborsaving machinery. Small firms economize on capital equipment by substituting labor, and many small wholesalers reduce the amount of capital needed by renting buildings and equipment.

Table 10.--Merchant wholesalers' sales per dollar of inventory and per dollar of asset, by asset size of firm, 1958-67

Year	All firms	Under $100,000	$100,000 to $1 million	Over $1 million
	Sales per dollar of inventory			
1958	17.89	49.28	20.36	14.80
1959	19.36	44.09	22.05	15.97
1960	18.77	38.53	21.05	15.79
1961	19.26	49.57	22.29	15.76
1962	20.03	37.58	23.87	16.69
1963	17.75	45.19	20.13	15.43
1964	19.53	44.27	23.02	16.61
1965	20.73	53.40	23.80	17.72
1966	20.59	47.71	27.26	16.50
1967	21.51	50.66	25.48	17.46
Average	19.44	46.03	22.93	16.27
	Sales per dollar of assets			
1958	5.32	7.32	5.85	4.74
1959	5.61	7.40	6.07	5.04
1960	5.33	7.48	5.77	4.76
1961	5.30	7.10	5.94	4.65
1962	5.42	6.57	5.94	4.93
1963	5.20	6.73	5.49	4.91
1964	5.56	6.99	5.73	5.31
1965	5.62	7.02	5.81	5.37
1966	5.48	6.79	6.25	4.92
1967	5.66	7.64	6.29	5.22
Average	5.45	7.10	5.91	4.96

Compiled from: Source Book of the Statistics of Income, Internal Revenue Service, 1958 through 1967 (latest available data).